

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF
RECHARGE CENTER CONTROLS
AT THE
UNIVERSITY OF CALIFORNIA, BERKELEY**

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG Office of Audit Services. Final determination on these matters will be made by authorized officials of the HHS operating divisions.



JUNE GIBBS BROWN
Inspector General

NOVEMBER 1995
A-09-95-04001



Region IX
Office of Audit Services
50 United Nations Plaza
San Francisco, CA 94102

CIN: A-09-95-0400 1
November 9, 1995

Thomas Vani
Executive Director, Business and Financial Services
417 University Hall
University of California, Berkeley
Berkeley, California 94720

Dear Mr. Vani:

The purpose of this letter is to provide you with the results of our REVIEW OF RECHARGE CENTER CONTROLS AT THE UNIVERSITY OF CALIFORNIA, BERKELEY (UCB).

OBJECTIVES

The overall objective of the review, conducted as part of a nationwide effort, was to determine whether adequate policies and internal control procedures existed for the operation of recharge centers in compliance with the Office of Management and Budget (OMB) Circular A-2 1.

The specific sub-objectives were to determine whether:

- recharge centers are adjusting billing rates to eliminate accumulated surpluses and deficits over a specified operating cycle;
- recharge centers are generally excluding duplicate or unallowable costs in calculating the billing rates;
- recharge center costs are generally excluded from the calculation of the indirect cost rates;
- recharge center funds are not being used for unrelated purposes; and
- recharge centers are charging all users equitably.

SUMMARY OF FINDINGS

The UCB's policies and procedures were generally consistent with OMB Circular A-21. Specifically, UCB has policies which require its staff to: (1) annually review recharge center billing rates, (2) base billing rates on costs, and (3) bill all users. In addition, UCB established the Campus Recharge Committee which has oversight responsibility of recharge centers.

Although UCB's policies and procedures were generally consistent with OMB Circular A-21, UCB did not adequately control and monitor recharge center operations to ensure compliance. Specifically, our review disclosed that:

- three recharge centers accumulated **large surplus fund balances**, resulting in \$400,120 of excess charges to federally sponsored projects (page 7);
- one recharge center inappropriately **transferred surplus funds** out of its operating account for unrelated purposes (page 8);
- two recharge centers charged **the cost of capital equipment purchases** to current operating funds @age 8);
- one recharge center used **unapproved billing rates** (page 9); and
- a most recharge centers were not credited for **interest income earned** on their cash balances (page 9).

PRINCIPAL RECOMMENDATIONS

To ensure compliance with the provisions of OMB Circular A-21, we recommend that UCB:

- ▶ establish controls and periodically monitor recharge center operations,
- ▶ correct specific conditions identified during our review,
- ▶ perform a self-evaluation of the recharge centers not included in our review, and
- ▶ request its independent auditors to follow up on corrective action regarding recharge centers as part of the OMB Circular A-133 audit.

UCB's COMMENTS

In written comments dated November 6, 1995, UCB concurred with all of the recommendations presented in the report.

INTRODUCTION

BACKGROUND

Recharge centers at universities, also known as specialized service facilities, operate as in-house enterprises and are used to finance, account for, and report upon the provision of goods and services to individual users or other operating units. These centers function as nonprofit businesses, funding operations through fees from users. Recharge centers typically include motor pools, telecommunications, computer centers, supply stores, animal care facilities and other specialized services.

The University of California (UC) educational system consists of the Office of the President and nine campuses statewide, including UCB. The Office of the President performs administrative functions for the system as a whole and supports all campus operations. At UCB, educational and research activities are conducted both on-campus and at various off-campus locations.

For the Fiscal Year (FY) ended June 30, 1994, UCB received over \$181 million in Federal research grants and contracts. For the same fiscal year, financial statements show revenues in excess of \$851 million and expenditures of \$828 million. As of June 30, 1993, UCB had established 67 operating accounts for recharge centers. Total FY 1993 revenue for these operating units was \$49.9 million.

The UCB established the Campus Recharge Committee to serve as the primary compliance review and advisory body on all recharge activities. Among its responsibilities, the Campus Recharge Committee provides training and guidance to recharge center management; reviews the methodologies used to establish recharge rates; approves recharge center rate proposals and billing rates; and makes recommendations on UCB recharge policies, guidelines, and procedures.

CRITERIA

The costs incurred by specialized service facilities for providing goods and services should be recharged to users based on established billing rates and actual services provided. Costs charged to Federal grants and contracts by UCB specialized service facilities must meet requirements set forth in OMB Circular A-2 1. Section J.44 of the Circular specifies that charges to users should be designed to recover not more than the aggregate cost of the services over a long-term period.

OBJECTIVES, SCOPE AND METHODOLOGY

Objectives

The overall objective of the review was to determine whether adequate policies and internal control procedures existed for the operation of recharge centers in compliance with OMB Circular A-2 1.

The specific sub-objectives were to determine whether:

- recharge centers are adjusting billing rates to eliminate accumulated surpluses and deficits over a specified operating cycle;
- recharge centers are generally excluding duplicate or unallowable costs in calculating the billing rates;
- recharge center costs are generally excluded from the calculation of the indirect cost rates;
- recharge center funds are not being used for unrelated purposes; and
- recharge centers are charging all users equitably.

Scope

Our review consisted of evaluating controls at the university-wide level and analyzing the fund balances of UCB's 67 recharge centers. We limited our review of UCB's internal control structure to reviewing controls over:

- the establishing, monitoring and periodic adjusting of billing rates,
- preventing unallowable costs from being included in recharge rates,
- preventing the use of recharge funds for non-related purposes, and
- the billing of recharge users.

We limited our detailed review to ten recharge centers.

TEN CENTERS SELECTED FOR REVIEW

- Chemistry Liquid Air
- Electrical Engineering and Computer Science
- Statistical Computing Facility
- Survey Research Center
- Telecommunications
- Engineering Services
- Office of Lab Animal Care
- Radio Astronomy Lab
- Information Systems and Technology (IS&T) Central Computing Services (CCS) Centrex Management System
- IS&T CCS General Services

Methodology

Our review was conducted in accordance with generally accepted government auditing standards.

From our analysis of UCB's 67 recharge centers, we judgmentally selected ten centers for detailed review based on several factors. The primary factors were total charges to Federal grants and contracts, unusual variations in fund balance, and size of the fund balance in relation to annual revenues.

We interviewed UCB personnel and reviewed records. We interviewed members of the Campus Recharge Committee and recharge center personnel. We also conducted interviews with the officials responsible for preparing the University's indirect cost proposal to determine whether controls were in place to exclude recharge center costs from the computation of the indirect cost rate. For the ten centers selected, we reviewed the FY 1994-95 rate proposals and supporting documentation. We also reviewed UC's OMB Circular A-133 audit reports for Fiscal Years ended (FYE) June 30, 1991, 1992 and 1993, and UCB Internal Audit reports covering recharge center operations issued within the last three years.

We relied on the fund balances provided by UCB's internal accounting records to compute the amount of excess charges to Federal grants and contracts. We used the fund balances as of June 30, 1994, adjusted for contributed capital, as the base amount for each selected center. The Federal billing percentage for each recharge center was based on an analysis of billings for FY 1993. For each recharge center, we multiplied the adjusted fund balance by the Federal billing percentage to determine the amount of direct Federal charges in each

fund balance. Additionally, since charges to Federal grants and contracts were subject to an on-campus indirect cost recovery rate of 49.5 percent for FY 1994, we added the amount of indirect costs applicable to direct Federal excess charges to determine the total Federal excess charges.

As part of our audit, we reviewed Telecommunications' methodology in determining the Federal share of excess direct charges for surplus fund balances maintained and inappropriate transfers out of its operating account. The **final** determination of the Federal share of excess direct and indirect charges was based on negotiations between UCB and the HHS Division of Cost Allocation (DCA). The two **findings** occurred during **FYs** 1990 through 1994 and were disclosed by the independent auditors in its FY 1993 OMB Circular A-133 report. Based on the independent auditors' recommendations and negotiations with DCA, UCB credited active Federal projects for \$337,008 in direct and indirect costs, and refunded \$396,295 in direct and indirect costs to the Federal Government for excess charges to those projects which were no longer active.

Our field work was conducted at UCB during November 1994 through June 1995.

FINDINGS AND RECOMMENDATIONS

The UCB's policies and procedures were generally consistent with OMB Circular A-21. Specifically, UCB has policies which require its staff to: (1) annually review recharge center billing rates, (2) base billing rates on costs; and (3) bill all users. In addition, UCB established the Campus Recharge Committee which has oversight responsibility of recharge centers.

However, our review disclosed that:

- three recharge centers accumulated large **surplus fund balances**, resulting in \$400,120 of **excess** charges to federally sponsored projects;
- one recharge center inappropriately **transferred surplus funds** out of its operating account for unrelated purposes;
- two recharge centers charged the cost of **capital equipment purchases** to current operating funds;
- one recharge center used **unapproved billing rates**; and
- most recharge centers were not credited for **interest income earned** on their cash balances.

These problems occurred because UCB did not adequately control and monitor recharge center operations to ensure compliance with OMB Circular A-21.

SURPLUS FUND BALANCES

Three of the ten recharge centers reviewed had accumulated surplus fund balances contrary to A-21 requirements. The three centers -- Chemistry Liquid Air, Engineering Services, and Survey Research Center -- operated with large surplus balances during FYs 1991 through 1994 and had accumulated \$683,583 in surplus funds at FYE 1994. This practice resulted in \$400,120 of excess charges, \$267,639 of direct and \$132,481 of indirect, to federally sponsored projects. Although the Campus Recharge Committee performed annual reviews of recharge center rate proposals, UCB did not require these centers to adjust subsequent billing rates in order to eliminate the surplus balances as required by Federal regulations.

Section J.44 of OMB Circular A-21 states:

*“Charges for the use of specialized facilities should be designed to recover not more than the **aggregate** cost of the services.... Accordingly, it is not*

*necessary that the rates charged for services be equal to the cost of providing those services during any one **fiscal** year as long as rates are reviewed periodically for consistency with the long-term plan and adjusted if necessary. "*

In addition, UC Business and Finance Bulletin A-56, effective April 15, 1986, states:

*"Recharge activity **shall** be operated on a no-gain/no-loss basis. Any surplus or deficit occurring in any one year shall be corrected by adjustment of rates in the succeeding year to achieve a break-even balance at the succeeding year-end. "*

TRANSFER OF SURPLUS FUNDS

One of the ten recharge centers, Telecommunications, transferred \$3.6 million in surplus funds out of its operating account between FYs 1990 through 1994 contrary to A-21 requirements. The transfers resulted because of inadequate monitoring of recharge activities by UCB officials. This practice resulted in \$367,661 of excess direct charges to federally sponsored projects.

The UC's independent auditors initially disclosed this finding in its FY 1993 A-133 audit report. The independent auditors also disclosed that Telecommunications had been accumulating excess surplus funds in its recharge account during the same period.

Ideally, recharge centers operate as closed systems -- recharge centers which accumulate surplus funds through overstated billing rates correct its practices by factoring in the surplus balances to compute subsequent billing rates. By transferring funds out of the recharge account, Telecommunications' surplus balances were not available to adjust subsequent billing rates.

As a result of the OMB Circular A-133 audit, Telecommunications computed the Federal share of the transfers and excess surplus funds accumulated. The UCB refunded the Federal Government for a portion of the excess charges and credited active Federal projects for the remainder. We reviewed the amounts transferred and determined that the methodology in UCB's refund calculation for the transfers was appropriate.

CAPITAL EQUIPMENT PURCHASES

Two of the ten recharge centers reviewed, Survey Research Center and Electrical Engineering and Computer Science (EECS), charged the cost of capital equipment purchases to current operating funds. Between FY 1991 through 1994, the two centers fully or partially expensed the cost of equipment to their operating accounts upon purchase or as payments were made.

This practice occurred because UCB officials did not adequately monitor recharge activities to ensure compliance with OMB Circular A-21 and UCB policies and procedures. In addition, management for both recharge centers was not aware that it was inappropriate to expense equipment costs to the recharge account upon purchase. This practice understated the Survey Research Center and EECS recharge centers' fund balances over the useful life of the equipment until the equipment was fully depreciated.

Generally accepted accounting principles (GAAP) require the cost of an asset to be spread over its expected useful life. OMB Circular A-21, which allows universities to be compensated for the use of their equipment through depreciation or use allowance, follows this basic concept of GAAP. In addition, UC Business and Finance Bulletin A-56, effective April 15, 1986, states:

"Costs incurred and assigned to the activity must be essential to the purpose for which the activity has been established. These shall consist of wages, wage-related costs, supplies, materials and equipment depreciation. Non-current expenditures such as for equipment acquisitions or facility modifications, may not be charged to current operating funds."

UNAPPROVED BILLING RATES

One of the ten recharge centers reviewed, Office of Lab Animal Care (OLAC), billed for services using billing rates which were not currently approved. The Campus Recharge Committee tentatively approved OLAC's FY 1993-94 billing rates from July 1, 1993 through October 1, 1993. The OLAC did not submit a revised rate proposal for the remainder of FY 1993-94 or for FY 1994-95, but continued to charge for services using the expired billing rates.

The UC Business and Finance Bulletin A-47, effective July 1, 1984, states that *"All recharge activities shall publish a schedule of rates and prices which shall be reviewed and approved by the Chancellor or his/her delegate."* Although UCB policy required all recharge centers to have approved billing rates in order to engage in recharge activities, UCB did not have adequate controls to ensure compliance. By permitting a recharge center to bill for services using unapproved billing rates, there is no assurance that the rates charged by the recharge center were in accordance with appropriate cost principles and with University and Federal regulations.

INTEREST INCOME EARNED

For most recharge centers, UCB did not credit interest income earned on the center's cash balances to the recharge account. As a result, recharge activities were not recovering the full revenues earned on their operations. This practice occurred because the UC's Business and Finance Bulletin A-60, a university-wide policy issued by the Office of the President, treats Short-Term Investment Pool (STIP) interest earned by recharge centers

inappropriately. For purposes of distributing interest, the Bulletin classifies specialized service facilities as campus unrestricted funds and specifies that interest earned on these funds be credited to an unrestricted account under the control of the Chancellor.

Although in some instances UCB credited interest income to the recharge account in which the interest was earned, generally the interest income was credited to an unrestricted account controlled by the Chancellor.

OMB Circular A-21, Section C.5. provides the following guidance on applicable credits:

"The term applicable credits refers to those receipts or negative expenditures that operate to offset or reduce direct or indirect cost items, "

"In some instances, the amounts received from the Federal Government to finance institutional activities or service operations should be treated as applicable credits. Specifically, the concept of netting such credit items against related expenditures should be applied by the institution in determining the rates or amounts to be charged to sponsored agreements for services rendered whenever the facilities or other resources used in providing such services have been financed directly, in whole or in part, by Federal funds. "

Interest earned on surplus balances of recharge centers that charge federally sponsored agreements are regarded as an applicable credit. The interest earnings should be netted against related expenditures of the recharge center and used in determining the rates to be charged to Federal agreements.

ROOT CAUSES

The UCB did not adequately control and monitor recharge center operations to ensure compliance with OMB Circular A-21 and with UC and UCB policies and procedures. In addition, UC's Business and Finance Bulletin A-60 treats interest earned by recharge centers inappropriately. For purposes of distributing interest, the Bulletin specifies that interest earned on specialized service facility funds be credited to an unrestricted account under the control of the Chancellor. Although the Campus Recharge Committee performed annual reviews of recharge center rate proposals, UCB did not adequately monitor recharge centers to ensure that centers:

- adjusted subsequent billing rates in order to eliminate surplus balances;
- did not transfer funds out of the recharge accounts for unrelated purposes;
- did not expense equipment upon purchase;

- billed for services using only approved billing rates; and
- were being credited for interest income earned on recharge center cash balances.

Because of UCB's inadequate controls, monitoring practices and policy regarding interest, recharge center management was not always aware of the appropriate procedures to follow in all aspects of recharge center operations.

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UNIVERSITY FOLLOW-UP

Our findings apply only to the ten recharge centers we reviewed. The UCB should perform a self-evaluation of the recharge centers not included in our review to determine those which may require an adjustment of billing rates or fund balances, or refund to the Federal Government. We also recommend that UCB request its independent auditors to follow up on corrective action regarding recharge centers as part of the OMB Circular A-133 audit.

RECOMMENDATIONS

To ensure compliance with the provisions of the OMB Circular A-21, we recommend that UCB:

- ▶ establish controls and monitor recharge operations to ensure that all centers:
 - adjust their billing rates to eliminate accumulated surplus and deficit balances;
 - only use recharge funds for purposes related to the operation of the recharge center;
 - capitalize equipment upon purchase and only recover equipment costs through charges for depreciation or use allowance to the recharge account;
 - use currently approved rates to bill for services; and
 - receive their share of interest income earned on cash balances.

- ▶ correct specific conditions identified as follows:
 - o adjust the billing rates to eliminate the surplus fund balances in the Chemistry Liquid Air, Engineering Services, and Survey Research Center recharge centers, or refund \$400,120 to the Federal Government for excess charges;
 - o adjust the fund balances of the Survey Research Center and EECS recharge centers to reflect the undepreciated balances of any equipment expensed upon purchase; and
 - o revise its policies and implement procedures to ensure that recharge centers are credited with their share of interest income earned on cash balances.
- ▶ perform a self-evaluation of the recharge centers not included in our review to determine those which may require an adjustment of billing rates or fund balances, or refund to the Federal Government.
- ▶ request its independent auditors to follow up on corrective action regarding recharge centers as part of the OMB Circular A-133 audit.

UCB's COMMENTS

In written comments dated November 3, 1995, UCB fully concurred with our recommendations. The complete text of UCB's response is included as an appendix to this report.

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We request that you respond to the HHS action official named below within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the **final** determination.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), HHS/OIG Office of Audit Services reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise. (See 45 CFR Part 5)

Page 13 - **Mr. Thomas Vani**

To facilitate identification, please refer to the Common Identification No. A-09-95-04001 in all correspondence relating to this report.

Sincerely,

A handwritten signature in black ink, appearing to read "Lawrence Frelot", with a stylized flourish at the end.

Lawrence **Frelot**
Regional Inspector General
for Audit Services

Attachment:

APPENDIX UCB's response, dated November 3, 1995

Direct reply to:

David S. Low
Division of Cost Allocation
Regional Administrative Support Center
Room 304, Federal Building
50 United Nations Plaza
San Francisco, California 94102

APPENDIX



FINANCIAL AND BUSINESS SERVICES

BERKELEY, CALIFORNIA 94720-1 103

November 3, 1995

Mr. Lawrence Frelot
Department of Health and Human Services
Office of the Inspector General
Office of Audit Services
50 United Nations Plaza
San Francisco, CA 94102

Dear Mr. Frelot:

CLN: A-09-95-0400 1

In response to the draft "Review of Recharge Center Controls at the University of California, Berkeley," (CIN: A-09-95-04001) issued on October 11, 1995, we are providing the following responses to the recommendations:

Recommendation # 1:

Establish controls and periodically monitor recharge center operations.

Response:

We concur. The Campus Recharge Committee will develop procedures to monitor recharge center operations. It is already University policy that recharge centers develop and maintain a system of internal controls for their operations.

Recommendation # 2:

Correct specific conditions identified during the review.

Response:

Surplus Fund Balances

We concur. It is University policy that we comply with OMB Circular A-21 in our recharge procedures. We will review the situation and adjust billing rates in future periods as required.

Transfer of Surplus Funds

We concur. Telecommunications was an isolated case. Again, it is UC policy that we comply with OMB Circular A-21 and adjust billing rates in future periods to reduce surpluses.

Capital Equipment Purchases

We concur. The Campus Recharge Committee will continue to educate and emphasize the need for compliance with established University policies and procedures, and federal regulations. The Campus Recharge Committee will develop procedures to monitor the recharge center operations.

Unapproved Billing Rates

We concur. The Campus Recharge Committee will continue to educate and emphasize the need for compliance with established University policies and procedures, and federal regulations.

Interest Income Earned

We concur. We are currently in compliance with established University policies and procedures. We will work with the Office of the President to change existing policy to ensure that we are in compliance with federal rules and regulations.

Recommendation # 3:

Perform a self-evaluation of the recharge centers not included in the review.

Response:

We concur. The Campus Recharge Committee will perform a self-evaluation of the recharge centers that are not included in this review.

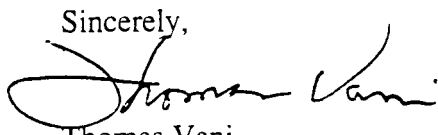
Recommendation # 4:

Request its independent auditors to follow-up on corrective action regarding recharge centers as part of the OMB A-133 audit.

Response:

We concur. We will request this to be included in the next A-133 audit.

Please let me know if you have any questions about these responses. You can reach me at 5 10-642-388 1.

Sincerely,

Thomas Vani
Executive Director
Financial & Business Services

cc: Director Siri
Acting Director Ono
Recharge Committee Chairperson Matteson
Manager Ohy